HIGH LOAN-TO-VALUE EQUITY LOANS

Beware!

In the past, the most you could borrow with a home-equity loan was the difference between your house's market value and the balance on your mortgage. Today, lenders are aggressively hawking a new breed of loan - known as a high loan-to-value (HLTV), or negative-equity mortgage - that lets you borrow as much as 25% more than your home is worth.

Say you could sell your home for $100,000 and you're carrying an $80,000 mortgage. Under the old rules, you could borrow $20,000 tops, if that. Now, however, lenders might offer you as much as $45,000 boosting the total debt on your $100,000 house to $125,000.

Although lenders initially pitched these loans in states where home values had declined, such as California, negative-equity loans have caught on nationwide. It's easy to see why homeowners - especially those tapped out on credit cards - are snapping these loans up.

After all, paying off credit-card balances with an HLTV loan can reduce your annual interest rate from 17% and higher to as low as 12.25%. Another plus; the interest on HLTV loans is typically tax deductible (though you may not be able to deduct interest on the loan amount that exceeds the value of your house). You can't deduct credit-card interest.

PROBLEMS

The problem is, these loans could endanger your financial health. First off, they're costly. Unless you have a sterling credit rating, for example, chances are you will pay interest of 15% to 16%, not the 12% to 13% touted in ads. You're also likely to face an outrageous six to 10 points in closing costs. Since each point equals 1% of the loan amount, closing fees could add as much as a $3,300 charge for the average $33,000 HLTV loan.

Many lenders also penalize you for paying off your debt within the first three years. In Indiana the allowable prepayment penalty on second or junior mortgage loans is 2% of the principal balance after any refunds (such as credit life insurance) at the time the loan is paid off. The prepayment penalty cannot be imposed after three years, if the loan is refinanced by the same creditor, the loan is paid off by insurance, or accelerated after default. Add that sum to closing costs and borrowers who pay off their loans early can face effective interest rates of almost 22%.

Furthermore, with housing experts projecting only modest rises in home prices, overloading your house with debt could turn your home into a prison. If you need to sell your house soon after taking out a no-equity loan, you might not be able to cover your mortgages.

Take the $100,000 home with the $80,000 first mortgage and the $45,000 HLTV loan. Even if real estate values claimed a generous 4% annually for four years, the house would sell for around $117,000. Subtract $7,000 for the standard 6% real estate agent's commission and you'd net $110,000. That means you'd have to dig into your pockets for another $15,000 to repay your mortgages.

HUNT FOR THE BEST DEAL

If you do not plan to sell your home in the near future and you believe a HLTV loan will help your financial picture, be sure to hunt for one with minimal fees. Some HLTV lenders only charge $150 to $450 in closing costs and may drop the prepayment penalty after just one year.

Finally, if you do wipe out your plastic debt with a negative-equity loan, don't rev up your credit-card balances again. It would be a good idea to close all paid accounts except one to use only in an emergency.

Negative-equity loans can give debt-strapped consumers a "fresh start," but if they start piling up new debts, then it becomes a "train wreck waiting to happen."

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

- Answers to Credit Problems
- Applying for Credit
- At Home Shopping Rights
- Bankruptcy Facts
- Buried in Debt
- Car Financing Scams
- Charge Card Fraud
- Choosing A Credit Card
- Co-Signing
- Credit and Divorce
- Credit and Older Consumers
- Deep in Debt?
- Equal Credit Opportunity
- Fair Credit Reporting
- Fair Debt Collection
- Gold Cards
- Hang up on Fraud
- High Rate Mortgages
- Home Equity Credit Lines
- How to Avoid Bankruptcy
- Indiana Uniform Consumer Credit Code
- Look Before you Lease
- Mortgage Loans
- Repossession
- Reverse Mortgage Loans
- Rule of 78s – What is it?
- Scoring for Credit
- Shopping for Credit
- Using Credit Cards
- Variable Rate Credit
- What is a Budget?
- What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information.

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